

# SME Platform – Challenges and Opportunities



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## Introduction

MSMEs (Micro, Small and Medium Enterprises) have long been recognized as an important element of the Indian economy, and even the leaders of the pre-independence era were strong supporters of this sector. They envisioned a vibrant and dominant MSME sector. MSMEs are complementary to large industries as ancillary units. They contribute to the rapid socio-economic development of the country.

In India, MSME Sector consists of about 36 million units. They provide 80 million jobs. The Sector through more than 6,000 products contributes about 8% to GDP besides 45% to the total manufacturing output and 40% to the exports from the country. Needless to add, SMEs need capital for growth and expansion, working capital, innovation and intangible financing, acquisitions, R&D, marketing, and so on.

Presently these enterprises are largely dependent upon banks or self-sourced finances. They find it hard to get financing and often the promoters, friends have to put their own money till the bank loans really disbursed. Some of the important government and SEBI initiatives have brought forth or facilitated institutions to fund these enterprises via SME exchanges, Alternate Investment Funds etc.

In this article we look at SME exchanges as a platform to propel the growth of SMEs.

## A beginning

SME exchange is a stock exchange dedicated for trading the shares of Small and Medium scale enterprises (SMEs). A primary reason leading to separate SME Exchanges is due to difficulties faced by SMEs in gaining visibility or attracting sufficient trading volumes when listed along with other stocks in the main exchanges. Worldwide trading platforms/exchanges for the shares of SMEs are known by different names such as Alternate Investment Markets (AIM). Indian markets have matured substantially over the past decade and are now open to the idea of a separate SME exchange. BSE SME Exchange was launched in March 2012 and NSE's Emerge was launched in September 2012.

The listing norms have been written to specifically suit SMEs and Initial Public Offering has been simplified leading to time saving for SMEs. A dedicated SME exchange gives a greater visibility as compared to small and mid-cap stock section on a bourse. SME platforms provide an immense opportunity for investors to identify and invest in emerging, high-growth SMEs and participate in the valuation of companies. Indian exchanges have kept minimum capital requirements comparatively low, to encourage relatively small companies to tap the equity market. However when the IPO size is small, they do pose challenges:

- To issuers: High cost of the IPO and the recurring costs associated with being a publicly listed company.
- To investors: Lack of earnings predictability compared to large corporations that access the public equity market.

## SME Exchanges Worldwide

World over there are many countries that operate separate exchanges for SMEs. These exchanges have been enabling SME as well as new entrepreneurs to access the capital market for financing their growth.

Some of the important SME Exchanges are:

Country	SME Market
China	<ul style="list-style-type: none"> <li>• SME Board - Shenzhen Stock Exchange (SZSE)</li> <li>• ChiNext (venture board) - SZSE</li> <li>• SME Private Placement Bond market</li> </ul>
Hong Kong	Growth Enterprise Market (GEM) of Stock Exchange of Hong Kong (SEHK)
India	<ul style="list-style-type: none"> <li>• SME Exchange - BSE</li> <li>• Emerge - NSE</li> </ul>

Korea	<ul style="list-style-type: none"> <li>• KOSDAQ (Korean Securities Dealers Automated Quotations) - Korea Exchange (KRX)</li> <li>• KONEX (Korea New Exchange) - KRX</li> </ul>
Malaysia	ACE(Access,Certainty,Efficiency)Market - Bursa Malaysia
Singapore	Catalist - Singapore Exchange (SGX)
Thailand	Market for Alternative Investment (MAIL) - Securities Exchange of Thailand (SET)
Denmark	GXG Markets - GXG Global Exchange Group
Sweden&France	Alternativa
Japan	MOTHERS (Market Of The High-growth and Emerging stocks), Tokyo Stock exchange
London	AIM (Alternative Investment Market) - London Stock Exchange
Canada	TSX – Venture Exchange

In the United States, there are various sources available for listing stocks. Some of them are:

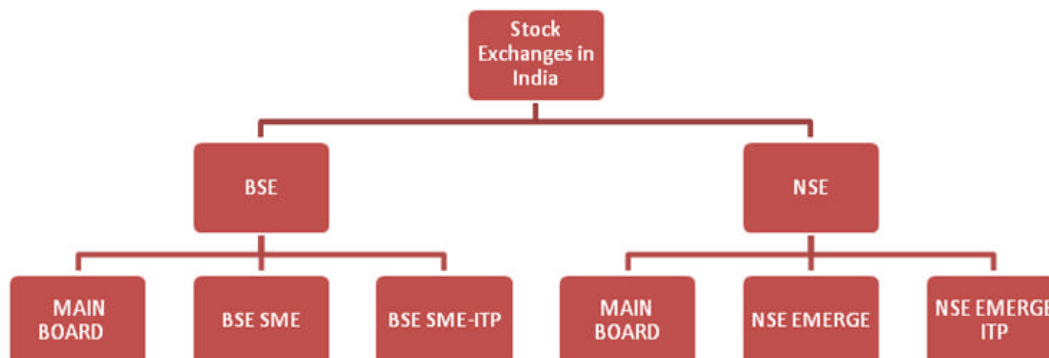
<b>SOURCES OF LISTING</b>	
<b>Exchange listed</b>	
NYSE	It is the world's largest stock exchange by market capitalization of its listed companies at US\$19.69 trillion as of May 2015.
NASDAQ	NASDAQ (National Association of Securities Dealers Automated Quotations), is an American stock exchange. It is the second-largest exchange in the world by market capitalization, behind only the New York Stock Exchange.
NYSE-AMEX	NYSE AMEX, formerly known as the American Stock Exchange (AMEX), is an American stock exchange.
<b>Non exchange listed</b>	
Pink Sheet	Unlike companies on a stock exchange, companies quoted on the pink sheets system do not need to meet minimum requirements or file with the SEC. Pink sheets also refers to OTC trading. The companies on the Pink Sheets are usually penny stocks and are often targets of price manipulation.
OTC Bulletin Board	The OTC Bulletin Board or OTCBB is a United States quotation medium operated by the Financial Industry Regulatory Authority (FINRA) for its subscribing members. It is used for many over-the-counter (OTC) equity securities that are not listed on the NASDAQ or a national stock exchange. Broker-dealers who subscribe to the system, which is not electronic, can use the OTCBB to enter orders for OTC securities that qualify to be quoted. The company may be listed on the OTCBB because it is unable to meet the initial listing requirements of the Nasdaq or NYSE.

SMEs can use any of the above avenues for listing of their equities in United States.

#### **Benefits of listing on SME Platforms**

- A company gets better valuation due to listing on the exchange. The debt equity ratio will also improve presenting a strong balance sheet. Venture Capital Funds have an Exit Route and thus are able to reduce their lock in period. Companies can provide Employee Stock Options that can ensure stronger employee commitment, participation and recruitment incentive.
- SMEs are able to get easy access to raise capital through equity infusion. Access to equity financing provides growth opportunities like expansion, mergers and acquisitions. Listing helps companies in finding a solution to their financial requirements to execute their expansion plans.
- Listing gives the SMEs greater credibility and enhanced financial status. This leads to a better demand for the company's shares. Monitoring of invested portfolio becomes easier due to benefits of disclosures and compliance requirements of a regulated platform. Listing also ensures robust corporate governance and internal controls and systems. Further, In case of listed securities Short Term Gains Tax is 15% and there is absolutely no Long Term Capital Gains Tax.

## STRUCTURE OF STOCK EXCHANGES IN INDIA



### SME Platforms in India

There are two types of SME trading platforms in India; viz., SME platform and Institutional Trading Platform. New chapters were added to the ICDR (Issue of Capital and Disclosure Requirements, 2009) to define the regulations applicable to the SME platforms.

**SME Exchange:** It means a trading platform of a recognized stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with its regulations. Some of the features are:

- Issuer with post issue face value capital up to Rs.25 crore shall be covered under the SME Platform.
- The minimum application amount as well as minimum trading lot shall not be less than Rs.1,00,000/-
- All existing Trading Members would be eligible to participate in SME exchange without any further registration.
- The issues will be 100% underwritten. Merchant Banker/s shall underwrite 15% in their own account.
- The Merchant Banker to the issue will undertake market making through a stock broker who is registered as market maker with SME Exchange. The Merchant Banker shall be responsible for market making for a minimum period of 3 years.

### BSE - SME Platform

BSE Ltd has set up the BSE SME Platform in March 2012. There are 88 companies listed on the BSE SME platform.

### NSE - SME Platform

NSE EMERGE was launched in September 2012. Since its launch platform has witnessed 7 listings of which 1 has migrated to the Main Board.

### Institutional Trading Platform (ITP)

**ITP** means the trading platform in a SME exchange for listing without an IPO and trading of specified securities of SMEs, including start-up companies. Some of the features are:

- The ITP shall be accessible only to informed investors who are either individuals or institutions and the minimum trading lot shall be 10 lakh rupees on this platform;
- Companies listed on ITP shall not make a public issue of its securities.
- Companies need to prepare an Information Memorandum and file it with the exchange. The listing criterion requires that such companies should have already received funding from either of a given set of investors or financial institutions.
- Companies to submit at least 1 year audited financial statements
- Companies should not be incorporated for more than 10 years
- It has revenues greater than Rs. 100 crore
- It has a paid up capital greater than Rs. 25 crore

### BSE – ITP

BSE Ltd has launched institutional trading platform in February 2014. On the BSE, there are a total of 21 companies listed on its institutional trading platform.

## NSE - ITP

EMERGE's Institutional Trading Platform (ITP) was established in April 2014. There are a total of 15 companies listed on its institutional trading platform.

There are certain distinctive features between SME Platform and the ITP. They are provided in the table below:

### SME PLATFORM -ITP

PARTICULARS	SME PLATFORM	ITP
Initial Public Offering	Yes	No
Source of information	Offer Document (DRHP)	Information Memorandum
Minimum application & trading lot	Rs.1 lakh	Rs.10 lakh
Private placement	Possible	Possible
Rights issue	Possible	Possible without option for renunciation
Migration	Simple process for migration to Main board	Only Exit. Company may approach EMERGE or the Main Board with a DRHP
Market making	Mandatory	Not mandatory
Reporting requirements	Half-yearly	Half-yearly

Source: Indian Securities Market A Review (ISMR) of NSE

A few statistics have been provided in the table below which highlights the success of the SME platforms:

### BSE SME Exchange - NSE Emerge (including ITP of both the exchanges)

Particulars	BSE SME	NSE Emerge
No of companies listed on SME Platform	88	7
Market Capitalization	Rs 7602.76cr	Rs 430 cr
Companies that filed offer documents	32	0
No. of companies migrated to main board	6	1
No of companies listed on ITP Platform	21	15

(Source: BSE and NSE websites, Data as on June 2015)

## Challenges

The SME exchanges are facing a few challenges. Some of them are listed below:

- The minimum lot size for an IPO as well as trading is Rs. 1 lakh that is not suitable for retail investors. Investors cannot exit early or book small profits due to the lot size. As a result liquidity is affected.
- SMEs have to necessarily appoint a merchant banker to manage issues. Merchant bankers who manage an SME listing are mandated to underwrite the new share offering and appoint brokers to act as market-makers for at least three years from the date of listing. SMEs have to pay fees to these merchant bankers for listing as well as for market making.
- The fundamental quality of these SMEs are not known since research from independent agencies is lacking. It is suggested that all such SME produce grading reports from SEBI approved credit rating agencies.

Globally, most of the SME exchanges are still at an evolving stage considering the many hurdles they are facing like, declining prices of listed stocks and their illiquidity, a gradual reduction in new listings and decline in profits of the exchanges etc. For instance, AIM had three predecessors; CATALIST succeeded SESDAQ with new regulations and listing requirements.

One of the exchanges has recently revised the entry norms for the platform. Companies are now required to have a post-issue paid-up capital of at least Rs 3 crore, from Rs 1 crore earlier. As a result many SMEs may not be able to list on that exchange.

A separate exchange for SMEs may become unviable due to reasons mentioned above and hence, may tend to be platforms of existing exchanges, necessarily to be cross-subsidised by the main exchanges. SMEs need to be convinced about the benefits of listing on the SME exchange. More awareness need to be created about the benefits of listing on an SME exchange by conducting presentations, Investor conferences, seminars and investor awareness programs. The exchanges can partner with various industry associations and trade bodies so as to provide a helping hand to SMEs to list on the SME exchange.

### **Opportunities**

The opportunities for SMEs to begin their great leap forward are enormous. SMEs can have access to this new platform which was hitherto available only to large corporates. Within three years after SME exchanges were introduced, three companies Bronze Infra-Tech, Anshu's Clothing and SRG Housing Finance migrated from the BSE SME platform to the BSE mainboard in February 2015. Similarly, Veto Switchgears And Cables Limited from the NSE Emerge has migrated to the main platform. More than 80 companies are currently listed on the BSE SME platform. Of these, more than 28 companies are actively traded. On the NSE Emerge, 7 companies have been listed. According to merchant bankers, many companies are eager to make the move to the mainboard listing and working towards meeting the requirements. India has more than 36 million SMEs. Even if say 20% of them are encouraged to tap the capital market, it would be a beneficial for both the SMEs as well as the exchanges. The SMEs should be guided onto a road map to migrate to the main board. For instance, to get listed on the main bourse the minimum paid up capital required is Rs. 10 Crore. To get listed on one of the SME Exchanges the paid up capital required is Rs. 3 crore at present. Though this looks like a large jump from the existing figures, as the SMEs grow in size they can raise additional capital and subsequently migrate on the main bourse. This will give them the necessary visibility and the prestige of being a listed company.

There is compulsory migration of SMEs from the SME exchange, in case their post issue paid up capital exceeds Rs. 25 Crore. This may be reduced to a comfort level of Rs. 10 crore to attract the SMEs with great potential. If we look at the way AIM has grown, it provides a great role model for the SME and how a platform can be leveraged to achieve the desired growth.

### **AIM's growth trajectory**

London based AIM (bourse for SME) has been in existence for about 20 years and is approximately 50 times bigger in market capitalization than the Indian SME Exchanges. AIM has 1,104 companies listed on it with a market capitalization of over £ 70 billion. Of these, 219 are international companies while the rest are UK-based. A total of 22 Indian companies are listed on the AIM.

AIM maintains a more flexible regulatory structure which better suits smaller, growing companies. Its rules do not impose a requirement for a minimum level of capitalization (unless the company is an investing company). Further, it also does not impose any requirements as to the company's trading history, the number of shares in public hands, or the pre-vetting of admission documents. The main requirement is that the company is "appropriate" for market.

### **Conclusion**

The MSME sector contributes significantly to the country's GDP, employment and exports; thus, play a vital role in the economic and social development of the country. There are numerous opportunities for this sector to enhance efficiency and serve both domestic and international markets, if the capital constraints are addressed. Listing of securities will promote the growth of such enterprises and will increase the marketability and liquidity of shares. There exists a ready market for trading the shares. Combined with the financial and managerial discipline that listing brings to the company, it will provide a good platform for the SMEs. Also, listed companies are more closely scrutinized by the market. However, there are challenges which need to be overcome. These are early days for the SME Exchanges as it takes time to settle down. We need to be patient since it is hardly more than 3 years since its introduction.

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India has a young and energetic entrepreneurial community and there is lot of activity in the start-up space. The SME platform provides a unique opportunity for all participants in the market ecosystem, whether they are small issuers, merchant bankers, wealth managers, or early-stage investors. The SME platform can potentially revolutionize the manner in which SMEs access public equity.

As stated above AIM which is approximately 50 times bigger in market cap than the Indian SME Exchanges and has 1,104 companies listed on its platform can be a successful role model for Indian SME exchange platforms. In the US the pink sheets and bulletin board platforms provide a vital recognition of the right SME. We may consider to try and emulate these US and UK models to make the Indian platforms achieve higher levels of success.

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